In the

United States Circuit Court of Appeals

For the Ninth Circuit

No. 5710

WALVILLE LUMBER COMPANY, a corporation,
Appellant and Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

UPON PETITION TO REVIEW AN ORDER OF THE UNITED STATES BOARD OF TAX APPEALS.

Reply Brief for Appellant and Petitioner

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The phases of the Brief for the Respondent which are the subject of this discussion, will be considered in the order presented by the respondent.

RESPONDENT'S STATEMENT OF FACTS.

We have no particular quarrel with the Statement of Facts as presented by the respondent (Resp.'s Br. pp. 6, 7, 8, 9). The appellant, how-

ever, believes that the facts in the case are very clearly set forth in the appellant's opening brief (App.'s Br. pp. 3, 4, 5, 6, 7, 8, 9), and would request the court to adopt the same as the facts of the case.

The petitioner heartily approves of the respondent's last paragraph on page 7 of respondent's brief, which reads as follows:

> "At the request of the Walworth & Neville Manufacturing Company, the preferred stock and the common stock which it had coming to it from petitioner were issued directly to the stockholders of the Walworth & Neville Manufacturing Company. In addition thereto, the 756 shares of common stock which were never issued by petitioner represented stock which petitioner would have received if it had issued to the Walworth & Neville Manufacturing Company all of the stock that was due that company when a liquidation of that company had taken place. (R. 7, 66.)"

This is exactly what the petitioner has been contending in this case at all times. It has always been the petitioner's contention that the petitioner in receiving the unissued 756 shares of its own common stock upon the reorganization which took place in 1919, received everything that it was entitled to receive upon a liquidation of the Walworth & Neville Manufacturing Company and received the identical amount of stock that it would have received if a legal liquidation of the Walworth & Neville Manufacturing Company had taken place

at the exact time of the reorganization. We are willing to have this court adopt said paragraph of respondent's brief as the finding of fact upon this particular question.

RESPONDENT'S SUMMARY OF ARGUMENT.

We challenge the first paragraph of respondent's summary argument on page 9 of its brief to the effect that:

> "The facts in the case show that petitioner, through a mutual arrangement entered into with the Walworth & Neville Manufacturing Company, voluntarily acquiesced in the surrender of assets which it was entitled to receive upon the dissolution of the manufacturing company in the year 1919."

There is absolutely no evidence in the record in support of this contention. As pointed out above, respondent in his own statement of facts, contradicts this contention in the last paragraph on page 7 of his brief.

Furthermore, there is no evidence in the record that the petitioner would have received any other assets than the unissued 756 shares of its own stock.

Respondent (Br. p. 8) admits that the Walworth & Neville Manufacturing Company had no assets other than its interest in the stock of the petitioner so that it clearly appears that upon the

legal dissolution of the Walworth & Neville Manufacturing Company, in the year 1919, the manufacturing company had no assets whatsoever.

RESPONDENT'S ARGUMENT.

I.

The facts as established by the record do not support the decision of the Board of Tax Appeals and overwhelmingly support the contention of the petitioner.

The respondent (Br. p. 10) states that:

> "The Board of Tax Appeals decided that had petitioner received the assets which it was entitled to receive upon the dissolution of the manufacturing company and which the petitioner could receive and would have received had it not voluntarily agreed to accept less, no loss would have been sustained by it."

We would call the court's attention to the fact that this is not a part of the board's findings of fact but is merely an assumption which the board indulged in its opinion (Tr. of Rec. p. 34) and that this court is just as capable to decide what conclusion should be drawn from the facts as they appear in the record as was the Board of Tax Appeals.

Furthermore, the respondent never at any time advanced the theory (and that is all that the same may be called) that the petitioner should have re-

ceived more than the unissued 756 shares of its own common stock.

We challenge the respondent to point out a single scintilla of evidence in the record in any way tending to show that the petitioner upon the dissolution of the Walworth & Neville Manufacturing Company should have received something more than the unissued 756 shares of its own common stock. The respondent merely relies upon the conjecture which the board saw fit to indulge in, and studiously refrains from pointing to the evidence in the case.

Respondent (Br. p. 12) charges the petitioner with singling out a portion of the testimony of John H. Neville by which the petitioner claims that the record conclusively established that the unissued 756 shares of stock were all that the petitioner was entitled to receive upon the dissolution of the manufacturing company, had the regular corporate formalities been carried out. The court has the entire transcript of record before it and we invite the court to read the entire "Statement of the Evidence" (Tr. of Rec. pp. 63-74 inc.) as certified by the United States Board of Tax Appeals to determine what the evidence is upon this point.

The testimony of John H. Neville as set out in petitioner's brief (pp. 21, 22) is all of the testimony upon this particular point.

Furthermore, the cross-examination of John H. Neville as conducted by the respondent at the hearing (Tr. of Rec. pp. 67, 68) clearly demonstrates that the respondent concurred in the petitioner's contention that the unissued 756 shares of common stock was all that the petitioner was legally entitled to receive from the Walworth & Neville Manufacturing Company. If the respondent did not believe the statement of John H. Neville, in this regard, why did he not cross-examine him to determine why this was all that the petitioner was entitled to receive.

Furthermore, it must be remembered that the petitioner is a business corporation and certainly must have conducted its affairs in a businesslike manner. Why should the petitioner give away to other people unrelated to it, assets to which it was entitled? Is not the action of a corporation entitled to the presumption of good faith until at least the good faith of the transaction is attacked?

The respondent in its brief (p. 14) states:

> "As pointed out by the board in its opinion (R. 34) a distribution by the manufacturing company to its stockholders in proportion to their respective stockholdings, would have given petitioner, who owned 4,400 shares of the 9,000 outstanding shares of the manufacturing company, title to 1,354¼ shares of its stock instead of 756 shares which it constructively received."

Respondent apparently overlooks the fact that the 9,000 shares of the manufacturing company con-

sisted of 1,000 shares of preferred stock and 8,000 shares of common stock and that all of the stock that the petitioner owned was common stock. Respondent apparently in this connection overlooks his own admission in his own statement of facts (Resp. Br. p. 8) to the effect that the Walworth & Neville Manufacturing Company was indebted to its own preferred stockholders. Hence, the so-called mathematical computation referred to by the respondent, has no application in this case as the respondent fails to take into account the outstanding preferred stock.

II.

As pointed out in petitioner's opening brief, the transaction was not a purchase back by petitioner of its own stock and petitioner is not claiming a loss on the purchase back of its own stock but is claiming a loss on its investment in 4,400 shares of stock in the Walworth & Neville Manufacturing Company, which became worthless in 1919.

The respondent admits (Resp. Br. p. 15) that the commissioner made the assessment upon the theory that this transaction was a purchase back by petitioner of its own stock. Also as pointed out by the appellant (App.'s Br. pp. 18, 19), the respondent urged the same contention before the Board of Tax Appeals, and at no time intimated that the petitioner did not receive everything it was entitled to receive upon the dissolution of the Walworth & Neville Manufacturing Company.

The effect of the transaction is not a purchase back of petitioner's own stock but is a loss on petitioner's 4,400 share investment in the common stock of the Walworth & Neville Manufacturing Company. We have no quarrel with the so-called "capital transaction" rule as set forth by the respondent in its brief, and also as set forth in the case of *Appeal of Simmons & Hammond Manufacturing Company,* 1 B. T. A. 803.

Respondent studiously avoids quoting from his cited case, apparently for fear that any quotation therefrom will clearly demonstrate that said case does not apply to the facts in the instant case as pointed out by the Board of Tax Appeals in the case of *Behlow Estate Co. vs. Commissioner of Internal Revenue,* 12 B. T. A. 1365 (Pet.'s Br. pp. 24, 25, 26).

We are unable to follow respondent's argument (Resp. Br. pp. 16, 17) to the effect that:

> "Even if there were something other than a purchase of stock and the transaction be considered as having been carried out in accordance with petitioner's theory with regular corporate formalities, the transaction does not disclose a real loss."

We do not know what the respondent means by "real loss." This is entirely a new term to us as the statute speaks of:

> "Losses sustained during the taxable year and not compensated for by insurance or otherwise." (Par. (4) of subdiv. (a) Sec. 234, Revenue Act of 1918.)

The record conclusively shows that the Walworth & Neville Manufacturing Company had no assets of any nature whatsoever at the time it was dissolved. In fact the respondent admits this (Resp. Br. p. 8); hence, petitioner's 4,400 share investment in the common stock of the Walworth & Neville Manufacturing Company became absolutely worthless in the year 1919 and the only thing which petitioner received on account thereof was its unissued 756 shares of its own common stock, having an admitted fair market value of $107,197.53. In this case the loss is no less real than the loss sustained by the taxpayer in the case of *Callanan Road Improvement Company vs. Commissioner of Internal Revenue,* 12 B. T. A 1109, cited in petitioner's opening Brief (App's Br. pp. 27, 28). In that case, the taxpayer corporation discharged its liabilities for a dividend with property, which at the time of distribution to the stockholders, had a market value of less than the cost to the corporation. The board allowed the taxpayer to deduct as a loss the difference between the cost of the property distributed and the fair market value at date of distribution.

With reference to the decisions cited by the petitioner in its opening Brief, the respondent merely states that the decisions cited are not in

point (Resp.'s Br. p. 17). The respondent studiously avoids analyzing the decisions cited and pointing out wherein they are not in point. We submit that the decisions cited are controlling in this case.

CONCLUSION.

The decision of the United States Board of Tax Appeals is not only not supported by the evidence, but there is no evidence of any kind whatsoever supporting the decision and all the evidence in the case is as contended for by the petitioner.

We submit that the respondent's Brief merely "begs the issue." There is not a scintilla of evidence cited by the respondent in support of the board's assumption that the petitioner did not receive everything it was entitled to receive upon liquidation and dissolution of the Walworth & Neville Manufacturing Company. All of the evidence is overwhelmingly to the contrary. The respondent never raised this contention either in his denial of the loss claimed by the petitioner or in his pleadings before the board or at any time during the hearing. The board itself indulged in the said assumption in its opinion and as heretofore pointed out made no finding of fact upon said point.

Upon the dissolution of the Walworth & Neville Manufacturing Company, no assets of any kind remained on hand and the only thing which the petitioner received on liquidation was its unissued 756

shares of its own common stock and the petitioner is, therefore, entitled to deduct as a loss, the difference between:

(1) the market value on March 1, 1913, of its 4,400 share investment in the Walworth & Neville Manufacturing Company in the sum of	$225,967.28

and

(2) the value of the unissued 756 shares of its own common stock of an admitted value of	107,197.53
or a deductible loss of	$118,769.75

We respectfully submit that the Order of Redetermination of the United States Board of Tax Appeals entered on May 31, 1928, should be reversed and the cause remanded to said board with instructions to allow the Walville Lumber Company a deductible loss of $118,769.75 in its income and profits tax return for the year 1919.

Respectfully submitted,

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